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## ARTICLES

### INTERNATIONALIZING THE LAW OF SECURED CREDIT: PERSPECTIVES FROM THE U.S. EXPERIENCE

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#### 1. INTRODUCTION

This symposium appears at a key moment in the development of international secured credit law.<sup>1</sup> The presence, both in person and in publication, of a large number of scholars and practitioners devoted to assisting the development is heartening. Moreover, it stands in stark contrast to the situation only a decade or two ago when most of those interested in this topic could have fit comfortably in a large telephone booth.

Rather than simply congratulating ourselves on our prescience or good judgment in choosing to study this area, though, we should survey the terrain. In particular, in considering what can be done to facilitate international secured transactions, we should familiarize ourselves with what might be called the Scenario of '99. In the Scenario of '99, we find that:

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<sup>1</sup> It also occurs at a key moment in the international development of domestic secured credit law, but that topic is beyond the scope of this article.

- different jurisdictions have widely different legal systems to govern secured credit;
- commerce among these jurisdictions is rapidly growing;
- financial transactions to support the growing commerce are lagging behind that commerce (perhaps because, in major part, of the legal friction resulting from inconsistent legal regimes); and
- legal friction resulting from inconsistent legal regimes is of two types: first, the law differs from jurisdiction to jurisdiction, and second, even within a particular jurisdiction, the rules differ depending on the type of the security device utilized.

The problems associated with this Scenario of '99 are obvious. Solutions are needed to facilitate the flow of commerce between jurisdictions.

Before jumping to any conclusions as to the nature of the appropriate solutions to the problems identified in the Scenario of '99 and the identity of the organizations best situated to effectuate them, however, a word of caution is in order. The Scenario of '99 described above is the Scenario of 1899, not 1999, and the jurisdictions referred to are the states of the United States rather than nations of the world.<sup>2</sup>

Those engaged in the study of secured credit under Article 9 of the Uniform Commercial Code ("UCC") tend to think that the U.S. system of unified and uniform rules governing security interests sprang full grown from on high, but as Professor Grant Gilmore reminded us, with some modesty on his part, "only in myth does Minerva spring fully armed from Jove's brow."<sup>3</sup> Indeed, in the United States, it took over a half century of sometimes fitful progress from 1899 to achieve our present state of domestic near-uniformity with respect to secured credit across both state lines and differing types of transactions.

Professor Gilmore, in his classic treatise *SECURITY INTERESTS IN PERSONAL PROPERTY*, extensively analyzed pre-UCC secured transactions law and its development over time. Gilmore identified eight different personal property security devices used in the United States in the late nineteenth century and early twentieth

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<sup>2</sup> The author also explored this theme in a lecture sponsored by the University of Vienna in October 1996.

<sup>3</sup> 1 GRANT GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* 291 (1965).

century.<sup>4</sup> These devices were the pledge, the chattel mortgage, the conditional sale, the trust receipt, the factor's lien, field warehousing, security interests in intangible property, and accounts receivable financing.<sup>5</sup> While the law governing each of these devices traveled a different route to the current state of unified and uniform law, the general stories are similar. In these earlier days the rules differed from device to device and from state to state, with any fitful movements toward uniformity developing only over time.

With respect to pledges and chattel mortgages, for example, not only did the rules differ from state to state, but the rules establishing the distinction between the two devices were unclear.<sup>6</sup> In a well-known early case, Judge Learned Hand noted that:

It is everywhere agreed that the significant distinction between a pledge and a mortgage is that in the first the creditor gets no title, but what is vaguely called a "special property," while in the second he does. . . . If only the forms of the transaction were observed by the courts, it would be easy to distinguish a pledge from a mortgage, because any absolute grant must be a mortgage, and any other agreement for security must be a pledge.

No such convenient rule can be drawn from the books  
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It seems to me very difficult to find any rule which the cases will bear out, and the whole matter floats nebulously in that fog, "the intent of the parties," but of which courts are so apt to evoke what they most want.<sup>7</sup>

Among the differences recognized in many states between the rules governing pledges and those governing chattel mortgages, those related to the rights of late perfecting pledges or mortgages

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<sup>4</sup> See *id.* at 3.

<sup>5</sup> See *id.* at xiii.

<sup>6</sup> See generally *id.* at 4-5 (comparing the pledge and the chattel mortgage).

<sup>7</sup> German Publication Soc'y, 289 F. 509, 509-10 (S.D.N.Y. 1922), *aff'd* 289 F. 510 (2d Cir. 1923).

as against intervening creditors present an interesting comparison. New York, Illinois, and Washington, for example, all recognized distinctions in this area between pledges and mortgages, but New York recognized different distinctions than did Illinois and Washington.<sup>8</sup>

Matters did evolve over time, however. Gilmore noted the example of the "stock in trade" mortgage, one example of a type of pledge or chattel mortgage transaction: "By the end of the [nineteenth] century, it was clear that no judicial consensus would ever be achieved, even within the limits of a single jurisdiction."<sup>9</sup> Yet, by 1940, "most states" had resolved matters similarly, and the problem "ceased to be a burning issue."<sup>10</sup>

With respect to conditional sales, the origins of the doctrine appear to be in the common law, but by the time of the enactment of UCC Article 9, only a handful of states continued to govern conditional sales as a common law device.<sup>11</sup> Over time, some states enacted the Uniform Conditional Sales Act, while others regulated conditional sales through their retail installment sales acts.<sup>12</sup>

The law governing trust-receipt financing appears to have reached some degree of uniformity relatively early. While the origins of this device, like the others, were in the common law,<sup>13</sup> it has "no history or genealogy that can be traced further back than the last quarter of the nineteenth century."<sup>14</sup> Moreover, an influential Uniform Act—the Uniform Trust Receipts Act—was promulgated in 1933 and was enacted in a majority of states. Thus, the path from nothingness to chaos to uniformity was unusually brief in the case of this device.

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<sup>8</sup> See GILMORE, *supra* note 3, at 6-7 (comparing New York law as exemplified by *Karst v. Gane*, 136 N.Y. 316 (1893) and *Parshall v. Eggert*, 54 N.Y. 18 (1873) with the law of Illinois as exemplified by *Johnson v. Burke Manor Bldg. Corp.*, 48 F.2d 1031 (7th Cir. 1931) and Washington as exemplified by *Whiting v. Rubinstein*, 109 P.2d 312 (Wash. 1941)).

<sup>9</sup> GILMORE, *supra* note 3, at 46.

<sup>10</sup> *Id.* at 47 (noting the example of stock in a trade mortgage).

<sup>11</sup> See *id.* at 63.

<sup>12</sup> See generally J. Glenn Donaldson, *An Analysis of Retail Installment Sales Legislation*, 19 ROCKY MTN. L. REV. 135 (1947); William E. Hogan, *A Survey of State Retail Installment Sales Legislation*, 44 CORNELL L.Q. 38 (1958).

<sup>13</sup> See Karl T. Frederick, *The Trust Receipt as Security*, 22 COLUM. L. REV. 395 (1922).

<sup>14</sup> GILMORE, *supra* note 3, at 86.

In the case of factors' liens, a common law device gradually came to be covered by statute in most states. New York, for example, first dealt with this area by statute in Section 45 of the Personal Property Law, enacted in 1911.<sup>15</sup> The statute was frequently amended, but for almost thirty years it appears that New York had the statutory field to itself. From 1938 to 1947, though, nineteen states passed factors' lien acts,<sup>16</sup> and the 1950s saw seven additional states enter the fold.<sup>17</sup> These acts, though, unlike the trust-receipt statutes, were not uniform from state to state. Gilmore states that they were "recognizably the same statute in substance, but they offered an amusing collection of local and regional tastes and styles in drafting."<sup>18</sup>

Field warehousing law followed still another path. As Gilmore explained:

Field warehousing . . . was nothing to get excited about; nothing for the legislatures to be concerned with; nothing that anyone would be tempted to describe as a great feat of the legal imagination. It was merely a remarkably successful security device that managed to exist for nearly half a century before anyone realized that it was there.<sup>19</sup>

Once the legal system did realize that field warehousing was there, however, it apparently was content to resolve issues on a case-by-case basis through common law analysis rather than by statute.

The law governing security interests in intangible property, such as accounts receivable, developed slowly, primarily through case law. In the 1940s, however, a large number of states enacted accounts receivable acts to govern the area by statute. The development of doctrines in this area was quite contentious and by no means uniform.<sup>20</sup>

As this brief historical excursion indicates, uniformity did not come easily or quickly in the United States. Indeed, with the exception of trust-receipts financing, it would be difficult to con-

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<sup>15</sup> See 1911 N.Y. Laws ch. 326, § 1.

<sup>16</sup> See GILMORE, *supra* note 3, at 139 n.1.

<sup>17</sup> See *id.* at n.2.

<sup>18</sup> *Id.* at 141.

<sup>19</sup> *Id.* at 146.

<sup>20</sup> See generally *id.* §§ 7.1 - 8.8.

clude that pre-UCC law for any of these security devices was uniform at any level deeper than the superficial. Moreover, before the promulgation of the UCC in the 1950s, there were no serious attempts to unify the legal treatment of security devices. Thus, the U.S. journey from late nineteenth century chaos to the current state of relative grace was neither quick nor smooth.

## 2. CREATING PROFITABLE TRANSACTIONS

Why do people care about the law governing secured credit? The simple answer is that credit is an engine of economic growth. Yet, credit will be extended only when the credit transaction is profitable for *both* parties—the creditor *and* the debtor.

How are profitable transactions constructed? The borrower will see a potential extension of credit as profitable if it anticipates a greater return on the loaned funds than it will pay in interest.<sup>21</sup> For the creditor, direct profits derive from interest charges in excess of the its time value of the money or its cost of funds.<sup>22</sup>

Obviously, individual extensions of credit are profitable for creditors only when their debtors fulfill their obligations, and the aggregate of credit extensions is profitable only if the profits from the transactions in which the borrowers fulfill their payment obligations are greater than the losses from those in which the debtors do not fully repay the credit. Accordingly, the possibility of nonpayment is a key determinant of the profitability of a credit transaction. Why does nonpayment occur? As I have noted elsewhere:

While in some cases a debtor's failure to fulfill his or her obligations is due to dishonesty or unwillingness to pay, much more often the failure springs directly from inability to perform. Inability to fulfill one's financial obligations,

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<sup>21</sup> Since the anticipated return is a constant, obviously the interest rate to be charged in the transaction plays the major role in determining whether the borrower sees the transaction as profitable.

<sup>22</sup> The creditor may also profit indirectly from the extension of credit, such as when the credit finances profitable sales (that might not otherwise have occurred) of the creditor's products or services to buyers. Many transactions generate profits for creditors both indirectly and directly—enabling a profitable sale that may not otherwise have taken place *and* making a separate profit from the interest charged to the customer.

of course, is part of the classic definition of insolvency. Thus, the risk of debtor insolvency is a major (perhaps *the* major) determinant of whether a credit transaction will be seen as profitable for the creditor.<sup>23</sup>

Accordingly, if a creditor believes that the risk of non-payment associated with a particular proposed extension of credit is too high, that extension of credit will not take place. This is the case because non-payment in the transaction in question would not only make that transaction unprofitable, but it would also offset the gains from many other transactions in which the debtors fully pay their debts.<sup>24</sup> By similar analysis, a creditor considering extending credit in a class of similar transactions will not do so if the risk associated with individual extensions of credit within that class is too high. In making such a decision, the creditor will note that even if the chance that any one debtor will default is relatively low, a small number of projected defaults will yield a negative expected value for the entire class.

It might appear that the creditor can ameliorate the problem of losses from debtor default simply by raising the interest rate so that the profits from the transactions in which the debtors pay are high enough to outweigh the losses from those in which the debtors default. This solution can work only in a narrow range, though. After all, raising the interest rate makes it less likely that the credit transaction will be profitable for the borrower. If the borrower does not see the transaction as profitable, it will not take place. Thus, when the risk of loss from debtor insolvency is high, it will be difficult to construct a credit transaction in which both parties foresee profits.

The history of credit, consequently, has involved the search for mechanisms to lower expected insolvency losses in order to lower the interest charges required for profitability for the creditor and thereby to facilitate the possibility of transactions that are profitable for debtors as well. Secured credit, along with surety-

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<sup>23</sup> Neil B. Cohen, *Harmonizing the Law Governing Secured Credit: The Next Frontier*, 33 TEX. INT'L L.J. 173, 174 (1998).

<sup>24</sup> Indeed, the loss associated with a defaulting debtor is typically several times larger than the profit generated by a debtor that fully performs its obligations. For further analysis of this point, see generally *id.*; Neil B. Cohen, *Credit Enhancement in Domestic Transactions: Conceptualizing the Devices and Reinventing the Law*, 22 BROOK. J. INT'L L. 21 (1996).

ship and guaranty devices, represents a mechanism to effectuate this solution.

### 3. THE NEED FOR A LEGAL FRAMEWORK

The availability of secured credit, especially in legal cultures where it is largely absent, can be a great spur to economic growth.<sup>25</sup> Yet secured credit cannot exist without a legal framework to support it.

While secured credit transactions are created by contract, contract law standing alone is insufficient to supply this legal framework. The reasons for this are at least three-fold. First, the value of secured credit springs from the secured party's claim to the collateral not only as against the debtor but also as against other potential claimants. These claimants can include other secured creditors, lien creditors, buyers of the collateral, and, most importantly, a bankruptcy trustee. None of these other potential claimants is a party to the contract by which credit is extended and a security interest created. Thus, it is not possible to use contract theory to establish the rights of the secured creditor as against these other claimants. Second, even as between the debtor and the secured creditor, there are rights that may well be too important to leave to the bargain of the parties in light of possible inequalities in bargaining power.<sup>26</sup> Third, without a body of law to establish default rules,<sup>27</sup> secured credit contracts would need to be of great (and often inefficient) complexity.

To support secured credit effectively, a legal regime must address three distinct issues. First, the regime must determine how a debtor and creditor may create *inter se* an enforceable agreement that certain property of the debtor will serve as collateral for the debtor's obligation.<sup>28</sup> Not only must the necessity of such formalities as signed writings be addressed, but also such issues as the

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<sup>25</sup> See Heywood Fleisig, *The Power of Collateral: How Problems in Securing Transactions Limit Private Credit for Movable Property*, PUB. POL'Y FOR PRIVATE SECTOR, n. 43 (Apr. 1995).

<sup>26</sup> Under Article 9 of the UCC, most post-default rights of debtors are not waivable in the contract creating the security interest. See U.C.C. § 9-501(3) (1995); U.C.C. § 9-602 (1999).

<sup>27</sup> The term "default rules" does not mean rules governing the parties after the debtor's default, but, it represents rules that govern in the absence of an agreement between the parties.

<sup>28</sup> This matter is dealt with domestically in U.C.C. § 9-203 (amended 1999).



ability of debtors to encumber disparate items of property in a single grant of a security interest and the ability to encumber anticipatorily property not yet owned by the debtor.

Second, a secured credit regime must set out the ground rules for enforcement of the secured party's interest after default by the debtor. For example, how may the secured party obtain physical possession of the collateral (if it is tangible) or control of the collateral (if it is not tangible)? May self-help be utilized, or must the secured party resort to the courts? What limits exist on the methods by which the secured party reduces the collateral to money and applies that money to the debtor's obligation?<sup>29</sup>

Third, and perhaps most important, a secured credit regime must delineate the rights of the secured party as against other claimants of the collateral. A security interest that is enforceable against the debtor, but is subordinate to the rights of another secured creditor or of a lien creditor, has much less economic value than an interest that is superior to those competing rights. Both moral and economic value judgments are required to determine the rules that establish priority among competing claimants.

#### 4. THE INTERNATIONAL LANDSCAPE

The approach of various legal systems to these fundamental legal issues of secured credit varies widely. While many nations have detailed secured credit law, the choices made by many civil law countries often differ significantly from the United States' approach and vary internally depending on the type of collateral involved.<sup>30</sup> The legal systems of countries with less fully developed economies often understate secured credit issues.<sup>31</sup> Finally,

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<sup>29</sup> Article 9 of the UCC addresses these issues in Part 5 of the 1995 text and Part 6 of the 1999 amended text. The Article 9 rules, largely favoring self-help repossession and non-judicial sales, contrast dramatically with the law in many other countries where the enforcement rules often prevent a secured creditor from reducing the collateral to cash (or having a court do so) until the economic life of the goods has essentially expired. See, e.g., Office of the Chief Economist of the Latin and Caribbean Region, World Bank Publication, No. 13873, *How Legal Restrictions on Collateral Limit Access to Credit in Bolivia*, at 18-19 (1994), available in The World Bank Group (visited Sept. 10, 1999) <<http://www.worldbank.org/pics/eco/13873.html>>.

<sup>30</sup> See, e.g., Carl S. Bjerre, *International Project Finance Transactions: Selected Issues Under Revised Article 9*, 73 AM. BANKR. L.J. 261, 268 & n.26 (1999).

<sup>31</sup> See, e.g., Harvard & Center for the Economic Analysis of Law, *Study: Thailand*, Center for the Economic Analysis of Law, *Publications* <<http://www.ceal.org/publications.html>> (forthcoming publication).

countries only recently making the transition from socialist economies to market economies do not always rank development of secured credit law as a high priority.<sup>32</sup>

As practical barriers to international commerce fall, there is a concomitant need for credit, particularly secured credit, to support this newly developing commerce and for law to support this credit. Moreover, it has been said (with only some exaggeration) that the world is divided between those regions in which the dominant economic feature is money looking for uses, and those in which the dominant economic feature is uses looking for money. It would seem that in a well-functioning market, money and uses would meet but, once again, an effective legal system supporting such a meeting must exist and be effective.

The differences among today's legal regimes governing secured credit (and the lacunae in many existing regimes) create many inefficiencies. With these inefficiencies, the cost of credit increases and the likelihood of profitable transactions decreases. The cost of credit increases for at least the following four reasons: (1) in an international transaction, there is substantial uncertainty as to which jurisdiction's law will govern various aspects of a secured transaction;<sup>33</sup> (2) the cost of acquiring knowledge of the laws of the jurisdiction that will govern the transaction can often be high; (3) the jurisdiction that will govern the transaction may have laws that are uncertain, adding an element of risk to the transaction; and (4) the governing jurisdiction may have laws that do not effectively promote secured credit.

Can these costs be lowered through international lawmaking? The precedents are not positive. Almost thirty years ago, the United Nations Commission on International Trade Law ("UNCITRAL") retained Professor Ulrich Drobnig of the Max Planck-Institut für Ausländisches und Internationales Privatrecht [The Max Planck Institute for Foreign and Private International Law] to submit a study on the legal principles governing security interests in the various legal systems of the world.<sup>34</sup> One function

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<sup>32</sup> For example, Poland has enacted a comprehensive secured credit law while the Ukraine has no post-Soviet secured credit law.

<sup>33</sup> See *History: The Creation of the United Nations Commission on International Trade Law (UNCITRAL)*, [1970] 1 U.N. Comm'n on Int'l Trade L.Y.B. 5, 13-14 U.N. Doc. A/CN.9/SER.A.

<sup>34</sup> See *Report of the Secretary-General: Study on Security Interests*, [1977] 8 U.N. Comm'n on Int'l Trade L.Y.B. 171, 173, U.N. Doc. A/CN.9/SER.A.

of the study was to assess the need for, and perhaps prospects for, accomplishing harmonization in this area of the law.

The study, published in 1977, comprehensively examined the law of nineteen nations, noting the similarities and differences among them in their treatment of basic legal issues in secured credit.<sup>35</sup> Not surprisingly, the differences were great. More important for the present purposes, though, the Drobniġ report also contained assessments to “help to consider the necessity or desirability of framing rules in this field on an international level, especially for the international movement of goods subject to security interests.”<sup>36</sup>

As part of these assessments, Professor Drobniġ catalogued prior attempts to achieve some degree of international uniformity with respect to security interests. These attempts included: (1) a uniform conditional sales act enacted by three Scandinavian countries (Norway, Sweden, and Denmark) during 1915-1917; (2) the UNIDROIT draft provisions of 1939 and 1951 concerning the impact of reservation of title in the sale of certain goods; (3) provisions in the draft European Economic Community Bankruptcy Convention of 1970 regarding the effect in bankruptcy of reservation of title in the sale of goods; and (4) model reservation of title clauses contained in several “General Conditions” elaborated by the United Nations Economic Commission for Europe.<sup>37</sup>

Professor Drobniġ also analyzed at some length two recent (at the time of his study) proposals for the harmonization of secured credit law that had been submitted to the Council of Europe. The first such proposal was made by UNIDROIT in 1968; the other was submitted by the Service de recherches juridiques comparatives of the Centre National Recherche Scientifique of Paris in 1972.<sup>38</sup> Together, these proposals put forth a range of possible unification efforts, from the “maximum” solution of creating a uniform security interest for international cases to the much narrower suggestion for a uniform document accompanying motor vehicles on which security interests could be entered. In addition, Professor Drobniġ noted the existence of a proposal to the Euro-

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<sup>35</sup> *See id.*

<sup>36</sup> *Id.*

<sup>37</sup> *See id.* at 208-10.

<sup>38</sup> *See id.* at 210.

pean Community as to the establishment of a central register for security interests.<sup>39</sup>

These attempts are unified primarily by their ineffectiveness in resolving non-uniformity in the law governing security interests.

Moreover, Professor Drobnič's analysis of those limited precedents did not engender optimism on his part about the likelihood of framing international rules governing security interests. With respect to the prospects of a uniform law convention, he concluded:

It would seem that international legislation in the form of a convention providing uniform rules of substantive and conflicts law is not appropriate in this case. As against international sales or international transportation or the international circulation of negotiable instruments, transnational incidence of security interests is as yet relatively moderate. It would probably be difficult to obtain sufficient government support for an international conference dealing with the relatively technical topic of security interests; and even if the text of an international instrument could be agreed upon, national parliaments would probably be slow and perhaps even reluctant to ratify such a text.<sup>40</sup>

Professor Drobnič also took a negative view towards developing recommendations for nations to adopt rules that would promote uniformity. "Mere recommendations, even if emanating from an international organization of the highest repute, will not command sufficient moral or other support for adoption by any sizable number of States."<sup>41</sup>

Only with respect to the possibility of developing a model law in this area was Professor Drobnič's view less bleak. Even

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<sup>39</sup> See *id.* (citing Fédération bancaire de la Communauté économique européenne, *Projet de Convention relative aux effets extraterritoriaux des sûretés mobilières sans dessaisissement*).

<sup>40</sup> *Report of the Secretary-General: Study on Security Interests*, [1977] U.N. Doc. A/CN.9/131, ¶ 4.2.1, at 218, reprinted in 8 Y.B. Int'l Trade L. 171, 218 (1977); [1977] U.N. Doc. A/CN.9/SER.A/1977.

<sup>41</sup> *Id.* ¶ 4.2.3.

there, however, he tempered his relative optimism with doubt, suggesting: "Perhaps moral persuasion or intellectual insight into the virtues of the model rules will move some States to adopt them. Others may need persuasion by more effective means such as insistence on the part of international financing institutions."<sup>42</sup>

### 5. ARE THE PROSPECTS BETTER IN 1999?

The pessimism of Professor Drobniig in 1977, however strongly justified at the time, should not be assumed to be equally valid in 1999. After all, much has changed in the twenty years since the Drobniig study. Not only have practical barriers to international commerce decreased dramatically in the intervening years, but there have been other developments as well, not all of which could have been anticipated in 1977.

For instance, other nations have joined the United States in enacting secured credit laws reflecting the concepts and policy choices on which Article 9 of the UCC is based.<sup>43</sup> In addition, the fall of command economies following the collapse of most communist regimes has resulted in opportunities for the wholesale rewriting of the commercial laws of many countries in order to make market economies workable.<sup>44</sup> Also, organizations outside the United States, such as the European Bank for Reconstruction and Development ("EBRD"), have drafted and proposed for adoption model acts governing secured transactions.<sup>45</sup> The EBRD Model Act is particularly significant because it is compatible with the structure of the secured transactions system created by UCC Article 9 and, therefore, deviates from many traditional European norms. Further, the World Bank and other organizations have

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<sup>42</sup> *Id.* ¶ 4.2.2.

<sup>43</sup> The enactment in most anglophone Canadian provinces of Personal Property Security Acts based on similar concepts to those in UCC Article 9 represents such an example. See *The Personal Property Security Act*, ch. 73, 1967 S.O. 305 (Ont.); see also Jacob S. Ziegel, *The New Provincial Chattel Security Law Regimes*, 70 CAN. B. REV. 681 (1991) (discussing provincial property security legislation).

<sup>44</sup> The role of CEELI (the ABA Center for Eastern European Law Initiatives) has been particularly prominent here.

<sup>45</sup> See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, *MODEL LAW ON SECURED TRANSACTIONS* (1994).

actively pushed for modernization of the secured credit laws of many nations.<sup>46</sup>

While many of these initiatives are still in progress and uncertain of success, modernization and harmonization are no longer far-fetched dreams. Nonetheless, the difficulties in developing international secured credit law, even in 1999, should not be minimized. Two fundamental aspects of the American legal terrain in 1899 which contributed to the successes of the ensuing half century are absent from the world scene in 1999. First, with the exception of Louisiana, all of the United States base their legal systems on our English inheritance. By way of contrast, the nations of the world, unlike the states of the United States, do not share a common legal heritage. Second, in the American constitutional structure, it is clear that the economic unit is the nation as a whole.<sup>47</sup> As a result, the United States may be said to share a predisposition toward unified and uniform approaches to economic law. Quite obviously, there is no such international predisposition.

## 6. RECENT INITIATIVES: UNCITRAL AND UNIDROIT

As the other papers for this symposium explore in more detail, the most important recent developments in the field of international secured transactions are today's primary topics—the UNIDROIT initiative with respect to interests in mobile goods<sup>48</sup> and the draft UNCITRAL convention regarding receivables financing.<sup>49</sup>

Unlike comprehensive secured credit regimes such as UCC Article 9, both projects have a limited focus—seeking to establish rules to govern only one type of collateral. In this regard, they draw from the U.S. experience (albeit probably not intentionally)

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<sup>46</sup> See, e.g., Office of the Chief Economist, Latin America and Caribbean Region, *supra* note 29, at 18-19.

<sup>47</sup> See U.S. CONST., art. 1, § 8, cls. 1-3, 5.

<sup>48</sup> See *Text of the Preliminary Draft UNIDROIT Convention on International Interests in Mobile Equipment as Reviewed by the Drafting Committee, in First Joint Session Report*, Unidroit CGE/Int.Int./WP/16, ICAO Ref. LSC/ME-WP/27 app I (Feb. 12, 1999).

<sup>49</sup> See *Text of the Preliminary Draft Protocol to the Preliminary Draft UNIDROIT Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment as Reviewed by the Drafting Committee*, UNCITRAL, U.N. Doc. A/CN.9/WG.II/WP.104 (1999) [hereinafter UNCITRAL Receivables Project].

by seeking uniformity and modernity first in a limited context. If these projects are successful, perhaps they can serve as the basis for broader-gauged unification of secured credit law in the future. Indeed, starting narrowly, as these projects do, may well increase the chances of such broader success in the future.

Both of these projects concern areas of secured finance in which there exists a consensus of sorts that uniform international rules are necessary, or at least worthy of serious consideration. This certainly increases the chances of success for the projects, especially by contrast to broader based reforms, which do not seem to have engendered the same level of support in the international context.

Will topic-specific harmonizations pave the way for broader unification and harmonization of the law governing secured credit? While the U.S. experience suggests optimism, there are, of course, as noted above,<sup>50</sup> many differences between harmonizing within a relatively homogenous national legal and business culture and harmonizing across economic and cultural, as well as legal boundaries.

## 7. UNCITRAL AND UNIDROIT: DIFFERENT APPROACHES TO DIFFERENT PROBLEMS

While the UNCITRAL and UNIDROIT projects are similar in that they focus on only one type of collateral, their approaches differ in significant ways. The UNIDROIT project focuses on objects that can move internationally in a literal sense. The rules that are being developed focus on several basic questions with respect to that object: (i) how to create an interest in the object, (ii) how to enforce an interest in the object, and (iii) how to determine the relative priority of interests in the object.<sup>51</sup>

Most importantly, and in contrast to the UNCITRAL project, the rules being considered to resolve these questions are, indeed, international substantive rules. The UNIDROIT project will provide answers to the questions delineated above, and those answers will apply to all transactions within their scope. In particular, priority matters will be settled through the use of an international registry in which interests within the scope of the convention can be noted.

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<sup>50</sup> See *supra* Part 2.

<sup>51</sup> See UNCITRAL Receivables Project, *supra* note 49.

The proposed UNCITRAL convention differs from the UNIDROIT project in at least two major ways. First, while its scope, like that of the UNIDROIT project, is defined by a type of collateral, the UNCITRAL convention's rules focus more on the parties than on the property. While this may be natural given the wide variety of economic rights that may fall within the definition of receivables, it does lead to some different emphases. For example, consider the different roles of filing systems. In the UNIDROIT project, the filing systems that are contemplated would be indexed by property—that is, a creditor seeking to lend against a piece of mobile equipment such as an airplane would search an index organized by airplane to see if any other creditor claimed an interest in that airplane. By contrast, under the optional filing system proposed in the UNCITRAL convention,<sup>52</sup> the creditor would search an index organized by debtor (like domestic UCC Article 9 indices) and, if an entry is found for the debtor, the creditor would then examine the entry to determine if it covered the receivables in question.<sup>53</sup>

The more fundamental difference between the UNCITRAL convention and the UNIDROIT project, however, lies in the UNCITRAL basic approach to uniformity. While the core rules of the UNIDROIT project are substantive in nature, this is not always the case with respect to the UNCITRAL convention. In fact, the convention does not determine the core rules regarding interests in receivables—the relative rights of competing claimants to those receivables. Rather, the convention merely tells us which nation's law will determine priority.<sup>54</sup> In other words, rather than providing a substantive solution to its key issue, the UNCITRAL convention gives only a conflict of laws pointer.

The reasons for this limited approach to resolving such a key issue are twofold. First, and most directly responsible, is the simple fact that the Working Group drafting the UNCITRAL convention was unable to agree on a substantive priority rule. As a general matter, individual delegations consistently advocated for the priority rules similar to those in effect in their nations. Since at least three different strands of priority rules for receivables are

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<sup>52</sup> See *id.* at Annex I & II.

<sup>53</sup> As noted below, the fact that the filing system is optional reflects of an important difference between the two proposed conventions.

<sup>54</sup> See generally Steven L. Schwarcz, *Towards a Centralized Perfection System for Cross-Border Receivables Financing*, 20 U.P.A. J. INT'L ECON. L. 455 (1999).



represented by members of the Working Group,<sup>55</sup> a consensus did not emerge.

Second, and perhaps more important, a convention priority rule that is inconsistent with the domestic priority rules of some nations would create an unstable situation with uncertain impacts on domestic transactions. Consider the case of a German account creditor<sup>56</sup> whose debtor<sup>57</sup> is also located in Germany. Under German law, if that account creditor assigns the same receivable twice, the assignee of the first assignment would have priority. Assume, though, that the convention adopted a substantive priority rule pursuant to which the first assignment to be registered would have priority. This situation would leave us with two simple priority rules and one very difficult question.

The first simple priority rule would mean that between two German assignees of that receivable, the assignee of the first assignment would have priority because the convention would be inapplicable because neither assignment met the convention's criteria of internationality.<sup>58</sup> The second simple priority rule would be that, as between two non-German assignees of that receivable, the assignee of the first assignment to be registered would have priority because the convention would apply to both of these international assignments.

What would happen, though, if the account creditor assigned the receivable twice—once to a German assignee and once to a non-German assignee? To make the question more challenging, assume that the assignment to the German assignee occurred first, but that the non-German assignee registered its assignment while the German assignee did not. If the convention priority rule applies, the non-German assignee will have priority because its as-

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<sup>55</sup> For example, priority in the United States and Canada, among others, is dependent on registration in a public registry. See U.C.C. § 9-322 (1999); U.C.C. § 9-312 (1995). Priority in France, on the other hand, is dependent on the time of notification of the account debtor, and priority in Germany is determined by the time of the assignment of the receivable.

<sup>56</sup> While Article 9 labels this party the “debtor,” the UNCITRAL convention would call this party the “assignor.” See U.C.C. § 9-102(a)(28) (1999); U.C.C. § 9-105(1)(d) (1995); UNCITRAL Receivables Project, *supra* note 49, art. 2.

<sup>57</sup> While Article 9 labels this party the “account debtor,” the UNCITRAL convention would simply call this party the “debtor.” See U.C.C. § 9-102(a)(3) (1999); U.C.C. § 9-105(1)(a) (1995); UNCITRAL Receivables Project, *supra* note 49, art. 2.

<sup>58</sup> See UNCITRAL Receivables Project, *supra* note 49, art. 2.

signment was the first (and only) one registered. If the domestic German rule applies, the German assignee will have priority because it was the assignee of the first assignment.

How would this conflict between a substantive convention priority rule and substantive domestic priority law be resolved? The conflict cannot be avoided. After all, it would be absurd or meaningless to conclude that the German priority rule applied to the assignment to the German assignee. A priority rule applied to the assignment to the non-German assignee because a priority rule resolves a conflict *between two assignments*; it cannot apply to only one assignment. Thus, only one of the two priority rules can apply.

If the German priority rule applies to this conflict, the result is quite unsatisfying. While the German assignee obviously would be delighted, application of the rule would render the convention meaningless. After all, it would bring about a situation in which an assignee that takes all the actions necessary to have first priority under the rules of the convention would nonetheless lose to a competing party that did not take those actions and whose existence might not be easily ascertainable. Thus, despite the substantive priority rule of the convention, the international assignee would always be subject to the vagaries of domestic priority law. This would vitiate any value from the convention priority rules. A potential international assignee would be required to ascertain and apply local priority rules in order to determine whether its interest would have first priority, undermining the transactional planning role of the convention rule.

If the convention priority rule applied to this conflict, though, a different problem would result. Even though the German assignee, by virtue of its first-in-time status with respect to its assignment, would win under domestic German law (the only law applicable to *its* assignment), it would nonetheless lose because it did not take a step (registration) relevant only to international assignments under the convention. Thus, the assignee of the purely domestic assignment, to whom the convention is not applicable by its own terms, would nonetheless have to comply with the convention to assure its priority. The result would be a substantive convention rule which, by its terms, only governs international interests but which, in practice, must be followed in purely domestic transactions as well.

In light of the unsatisfactory results that would follow whenever there would be a potential conflict between domestic priority rules and substantive convention priority rules, it may well be the case that substantive convention priority rules would be inadvisable even if the members of the Working Group could achieve a consensus.

#### 8. BROADER PROJECTS ON THE HORIZON: THE ALI AND THE OAS CONSIDER SYSTEMATIC INTERNATIONALIZATION

The UNCITRAL and UNIDROIT projects both follow a gradualist approach that parallels early U.S. development of the law governing security interests. Yet, there are those who are interested in considering the possibilities of broader-based reform.

The most prominent of those groups considering the prospects of long term harmonization is the American Law Institute ("ALI"). The ALI recently instituted an International Secured Transactions Project. As stated in the prospectus for this project:

The goal of the proposed International Secured Transactions Project would be to promote and assist the development of effective and efficient legal regimes for secured transactions in the contexts of international law, United States domestic law, and the domestic law of other nations. The Project would seek to accomplish that goal through both participation in the United States component of international lawmaking and facilitation of the development of domestic secured transactions regimes in other nations. This could be accomplished through both institutional involvement in various lawmaking processes and the development of substantive products to aid those processes. Such products could include (1) an articulation of the economically beneficial goals of secured transactions law in a credit economy; (2) preparation of a Restatement-like "Principles of United States Law of Secured Transactions"; (3) articulation of criteria for an efficient, effective, and appropriate legal regime governing secured transactions; (4) analysis and articulation of the need for, and operational issues with respect to, notice filing systems; (5) preparation of a model secured transactions code for enactment as the domestic law of a nation; and (6) prepara-

tion of a model international secured transactions law to govern international secured transactions in an integrated and comprehensive fashion.<sup>59</sup>

While the International Secured Transactions Project is not committed to preferring broad harmonization initiatives over the gradualist approach, it is clear from this statement of goals that the project is oriented toward facilitating the long term goal of broad harmonization.

Even more recently, the Organization of American States ("OAS") announced that it was considering a project to develop an inter-American convention on security interests.<sup>60</sup> The plan for that convention suggests that it will be more broadly based than either the UNCITRAL or UNIDROIT projects. Indeed, it is likely that the OAS project will be heavily influenced by the work of The National Law Center for Inter-American Free Trade of the University of Arizona, which has been developing a model secured credit law for Mexico over the past several years.

In any event, we are getting ahead of ourselves. This symposium and the remaining articles in this volume address the current efforts. The task of future reformers cannot be fully understood until the fate of the current efforts becomes clearer.

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<sup>59</sup> Neil B. Cohen, *The International Secured Transactions Project: A Proposal and Outline* (1997) (on file with author).

<sup>60</sup> See Organization of American States, *Law Experts Prepare for CIDIP-VI* (visited Dec. 7, 1998) <<http://www.oas.org/sp/pinfo/week/weekrep.htm>>.